[ESMA finds continued high risks as financial markets remain highly volatile]

The European Securities and Markets Authority (ESMA), the EU's securities regulator, today publishes the first [Trends, Risks and Vulnerabilities (TRV) report of 2020]. ESMA identifies continued high risks and a weaker economic outlook as markets remain highly sensitive to geopolitical events. The risk outlook is stable, however risks are high, particularly in the securities markets and for retail investors.

This TRV is the first report since the entry into force of the new ESA Regulation on 1 January 2020 and, in line with ESMA's new mandate, includes new sections about sustainable finance and consumer protection.

Risk outlook is stable, with an increase in potential sources of financial risk

- **Market risk** remained very high in the second half of 2019, due to excessive asset valuations in the context of weaker growth prospects, looser monetary policy and continuing uncertainties such as those on Brexit and on US-China trade relations. Equity markets experienced recurring episodes of volatility and bond spreads tightened in signs of continuing search-for-yield. Markets remained highly sensitive to events, as was visible in reactions to recent oil price shocks and the US repo squeeze;
- **Credit risk** and **liquidity risk** remained high. Credit risk, in particular, remains elevated with deteriorating corporate debt quality and increasing risks of *fallen angels* (bonds being downgraded to below BBB) as the share of BBB-rated debt grows;
- **Consumer risks** persist across key investment products as market risks increase. Overall, retail investors remained cautious, predominantly allocating savings to bank deposits:
- **Looking ahead,** ESMA sees a weaker economic outlook and continuing uncertainty over the potential impact of the coronavirus, global trade negotiations and Brexit.

Focus on risks in bonds, BigTech and short-termism

This TRV also takes an in-depth look at specific risk issues in three articles:

- **EU funds risk exposure to potential bond downgrades:** ESMA has simulated the impact of a wave of downgrades of fallen angels on bond funds and finds that the direct impact would moderately affect fund performance. Asset sales from bond funds would only have a limited and non-systemic impact on asset prices, though EU bond funds could amplify certain shocks;

- **BigTech – implications for the financial sector:** This article looks at the importance of large technology firms (BigTechs) that increasingly offer financial services, taking advantage of their vast customer networks, data analytics and brand recognition. ESMA’s analysis considers the impact these firms could have and concludes that regulatory cooperation is needed to manage financial stability risks that could arise as BigTechs increase market concentration; and
- **Short-termism pressures from financial markets:** ESMA considers the recent evidence collected by a survey on drivers of short-termism, carried out in response to the European Commission’s request to collect information on potential undue short-term pressures in financial markets. Survey results suggest that the misalignment of investment horizons and the remuneration of fund managers and executives could be a potential source of undue short-termism.